

**IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

FRANK FUMAI,	:	CIVIL ACTION
	:	
Plaintiff,	:	
	:	
v.	:	
	:	
HARVEY LEVY, SUBURBAN	:	
THERAPY, INC., and	:	
SUBURBAN MEDICAL ASSOCIATES,	:	
	:	
Defendants.	:	NO. 95-1674

MEMORANDUM

Reed, J.

January 16, 1998

The Court issues this memorandum in support of its Order dated January 9, 1998 (Document No. 42), in which the Court denied the motion of defendants Harvey Levy ("Levy"), Suburban Therapy, Inc. ("ST"), and Suburban Medical Associates ("SM") (collectively "the defendants") for partial reconsideration of the Order dated December 19, 1997 (Document No. 38) and granted in part the renewed motion of plaintiff Frank Fumai ("Fumai") in limine to exclude all evidence and argument at trial that pertains or relates to the defendants' claim or defense that Fumai breached a fiduciary duty owed to Allegheny United Hospitals ("Allegheny") in connection with the sale of the assets of ST and SM to Allegheny (Document No. 37).

I. BACKGROUND

The following background facts are undisputed.¹ On November 1, 1990, Fumai entered into an agreement with the defendants whereby Fumai would receive a commission from the sale of capital stock or assets of ST and SM if he procured a purchaser or introduced a party to the defendants who later introduced or procured a purchaser. Under the agreement, Fumai would receive 10% of the purchase price of ST and 5% of the purchase price of SM for such a sale.

At the time of the contract between Fumai and the defendants, the main business of ST was the management of physician care services, including management of SM. ST also owned and leased real property, among other ventures. SM owned and operated primary care physician offices.

There were multiple connections between Fumai and the defendants. At the time of the contract, Levy was the chairman of the board of ST and chairman of the board and president of SM. Fumai was then the executive director of Warminster General Hospital (“Warminster”). In addition, Levy was on the board of advisors of Warminster. Warminster was part of United Hospital Systems, Inc. (“United Hospitals”). In a joint venture, Warminster, ST, and SM owned an physical rehabilitation establishment known as the Achievement Center. ST and SM also made referrals of patients to Warminster.

After the contract was signed between Fumai and the defendants on November 1, 1990, Fumai contacted Continental Medical Systems (“Continental”) to set up a meeting with the defendants to discuss the possibility of Continental purchasing ST and SM. Continental signed a

¹ In addition, some of the facts were established by stipulation of the parties or confirmed in the trial that was held on January 12 and 13, 1998.

letter of intent to purchase ST and SM; however, the transaction subsequently fell through and Continental did not purchase ST or SM.

In January of 1991, Allegheny United Hospitals (“Allegheny”) took over the management of United Hospitals so that it could perform due diligence to determine whether it wanted to acquire United Hospitals. Fumai approached the president and CEO of Allegheny, Sherif Abdelhak about the potential for Allegheny to acquire SM and ST, providing Abdelhak with information about the companies including a copy of the letter of intent between Continental and the defendants. Although Fumai set up a meeting between the defendants and Allegheny, he did not attend the meeting nor did he participate or play any role in the negotiations that ensued between the defendants and Allegheny.

Allegheny acquired United Hospitals (Fumai’s employer) in July of 1991. At that time, Fumai was transferred to Centennial Health Services (“CHS”), a part of Allegheny. On July 24, 1991, Fumai resigned from CHS and left their premises. On September 16, Allegheny entered into an agreement to purchase the assets of ST and SM; the transaction closed on October 11, 1991. ST and SM received approximately \$11.5 million from the sale. Fumai claims that he is entitled to a fee calculated on the entire \$11.5 million from the sales of the assets of ST and SM to Allegheny. To date, defendants have paid Fumai \$454,000 in fees under the contract in the following increments: \$324,000 in October 1991 after the closing, \$60,000 in October 1992, \$50,000 in October 1993, and \$20,000 in October 1994. No payments have been made to Fumai since October of 1994.

The defendants contend that the contract between Fumai and them is void or unenforceable as against public policy because Fumai violated his fiduciary duties to them and to

Allegheny by the actions he took or failed to take in his purported performance of the contract. The defendants claim that Fumai breached his fiduciary duty to them when he quashed the potential transaction for the sale of ST and SM to Continental in favor of a sale to his new employer, Allegheny, and that Fumai breached his fiduciary duty to Allegheny by his failure to disclose to Allegheny his interest in the sale of ST and SM when he proposed the sale to Allegheny. Thus, the defendants argue that they do not owe Fumai any money under the contract because it is void or unenforceable. In addition, the defendants assert as a counterclaim that they are entitled to restitution of the commissions they have already paid to Fumai.

The defendants moved for partial reconsideration of the Court's Order of December 19, 1997, in which this Court granted plaintiff's motion in limine excluding all evidence and argument regarding the alleged quashed transaction between Continental and the defendant. In addition, Fumai renewed his motion in limine for the exclusion of all evidence and argument regarding the alleged breach of fiduciary duty to Allegheny by Fumai, which the Court denied without prejudice in the Order of December 19, 1997.

II. ANALYSIS

The Court will assume without deciding that the following contentions of the defendants are true for the purposes of this memorandum: (1) that Fumai owed fiduciary duties to Allegheny, based on his alleged employment by Allegheny, and to the defendants, based on the contract between the defendants and Fumai, and (2) that Fumai breached his fiduciary duties to Allegheny and the defendants by the actions he took or failed to take while purportedly acting in fulfillment of the contract between Fumai and the defendants. Framed in this way, the

dispositive issue for the motions that were pending before the Court at the time of its Order of January 9, 1998 was whether the defendants are able to avoid their obligation under the contract because of the assumed breach of Fumai's fiduciary duties.

Research on this issue reveals that there is more than a little confusion surrounding the terms "void contract," "voidable contract," and "unenforceable contract." For the sake of clarity, these terms will be defined here for the purposes of explaining the disposition of the motions. In their argument that the contract is "void" as against public policy, the defendants contend that the contract cannot be enforced under any circumstances nor be ratified by a party's actions. This is somewhat consistent with the Restatement (Second) of Contracts (hereinafter referred to by various section numbers). In the comment to § 7, the Restatement explains that although a "promise for breach of which the law neither gives a remedy nor otherwise recognizes a duty of performance by the promisor is often called a void contract," such a promise is not a contract but an agreement that lacks legal effect. See also Yannuzzi v. Commonwealth, 390 A.2d 331, 332 (Pa. Super. Ct. 1978) ("It is true that there is an important technical distinction between 'void' and 'voidable': The term 'void' is properly applied to those contracts that are of no effect whatsoever, whereas a 'voidable' contract can be cured by the act or confirmation of one of the parties.") Thus, a void contract or agreement is one which cannot be enforced and for breach of which there is no legal remedy.

Under § 7, a voidable contract is defined as "one where one or more parties have the power, by a manifestation of election to do so, to avoid the legal relations created by the contract, or by ratification of the contract to extinguish the power of avoidance." Comment (e) to § 7 explains that "[t]he propriety of calling a transaction a voidable contract rests primarily on the

traditional view that the transaction is valid and has its usual legal consequences until the power of avoidance is exercised. . . . [T]he term voidable contract is appropriate if ratification by one of the parties would terminate his power of avoidance and make the contract enforceable against him.”

The term “unenforceable contract” is perhaps the source of the most confusion. The defendants have used the term “unenforceable contract” interchangeably with the term “void contract” to indicate an agreement without legal effect. However, § 8 of the Restatement defines an unenforceable contract as “one for the breach of which neither the remedy of damages nor the remedy of specific performance is available, but which is recognized in some other way as creating a duty of performance, though there has been no ratification.” Again, the Comment is instructive: the statements “one party to an unenforceable contract may have a power to make the contract enforceable by all the usual remedies” and “some legal consequences other than the creation of a power of ratification follow without further action by either party” indicate that unenforceable contracts may be ratified through the actions of one of the parties. In addition, the Comment to § 8 categorizes a voidable contract as one type of unenforceable contract.

The Restatement provides guidance on the issue of when a contract is considered unenforceable as against public policy. Section 193 provides that “[a] promise by a fiduciary to violate his fiduciary duty or a promise that tends to induce such a violation is unenforceable on grounds of public policy.” However, a party may through his actions affirm such a contract and lose the opportunity to avoid it. Section 380 provides that “[t]he power of a party to avoid a contract for incapacity, duress, undue influence or abuse of a fiduciary relation is lost if, after the circumstances that made the contract voidable have ceased to exist, he manifests to the other

party his intention to affirm it or acts with respect to anything that he has received in a manner inconsistent with disaffirmance.” In the Comment to this section, affirmation of a contract is illustrated by action “that manifests a willingness to go on with the contract” including “words or other conduct, including the exercise over what he has received in a manner inconsistent with avoidance of the contract.” See also In re Estate of Long, 615 A.2d 421, 422-23 (Pa. Super. Ct. 1992) (discussing § 380(2) of the Restatement and general contract principles and holding that the appellant could not avoid his prenuptial agreement on the grounds of misrepresentation because he had affirmed the contract by keeping the benefit of his bargain and failing to disaffirm the contract when he learned about the misrepresentation).²

The agreement between Fumai and the defendants is not unenforceable as against public policy under § 193 of the Restatement. At the time the agreement was made, the promises made were not in violation of Fumai’s fiduciary duties, nor did the agreement tend to induce a violation of Fumai’s fiduciary duties. First, at the time the agreement was made, November 1, 1990, Fumai had no fiduciary duty to Allegheny; there is no evidence that Fumai was employed by Allegheny at the time of the contract, and the defendants have not argued that Fumai had a fiduciary duty to Allegheny when the agreement was signed. Second, the agreement on its face did not tend to induce a violation of any fiduciary duty; the agreement did not require Fumai to approach specific potential buyers, therefore the contract permitted Fumai to seek buyers to which he owed no purported fiduciary duty. The terms of the contract were such that there were a large number of potential buyers to whom Fumai could have marketed the sale of ST and SM without violating his alleged fiduciary duties to Allegheny or to the defendants.

²

This case demonstrates that Pennsylvania has adopted Restatement (Second) of Contracts § 380.

The cases cited by the defendants in support of their contention that the contract is void or unenforceable as against public policy are inapposite. Of the cases relied on by the defendants, the only one that is even close to the factual situation here is Colonell v. Goodman, 78 F. Supp. 845 (E.D. Pa. 1948), a case in which a third party sought to avoid payment of commissions under a contract with a corporate official on the basis that the contract breached the official's fiduciary duty to the corporation. However, the terms of the contract and the acts attributed to the corporate official are so quantitatively and qualitatively different than the acts attributed to Fumai, the case is easily distinguished. See id. at 846-47 (describing the relevant facts as "an important official of a corporation, entrusted particularly with the promotion and maintenance of sales, who, without his employer's knowledge, sets about detaching one of his employer's largest customers and endeavoring to give its business to one of his employer's competitors, his purpose being to improve the business position of the customer with which he hopes. . . to associate himself.")

Fumai points out that the defendants have not argued that the agreement to sell ST and SM to Allegheny was one-sided or unfair to Allegheny; indeed, to date, Allegheny has not tried to rescind the contract for the its purchase of the assets of ST and SM, nor tried to recover the fees Fumai received pursuant to the contract with the defendants. Thus, I find that the contract is not void as the defendants contend, but rather, if anything, the contract was voidable by the parties. See Salem Iron Co. v. Lake Superior Consolidated Iron Mines, 112 F. 239, 244-45 (3d Cir. 1901) (noting that in a case in which a member of a firm who made a contract with a company in which the firm owned stock that "[a] contract so made was undoubtedly voidable, and not void, unless the proofs should show that the conduct of the person acting in such a dual

relation amounted to fraud. This it might do if it were unfair and one-sided, and palpably to the advantage of one party alone to the contract.”); In re Specialty Tape Corp., 132 B.R. 297, 302 (W.D. Pa. 1991) (“The fact that a director has a personal interest in a contract does not render the contract ipso facto void.”); Deeds v. Gilmer, 174 S.E. 37, 74 (Va. 1934) (“[O]rdinarily, in the absence of proof of actual bad faith toward the corporation on the part of the officer or director, a contract between him and a third party by which he participates in the profits of a contract between the third party and the corporation is not per se void or voidable as between him and the third party. Generally any equities which arise from such a situation are equities in favor of the corporation or its stockholders and not of the third party.”).

Even if the contract between Fumai and the defendants became voidable at the time Fumai allegedly breached his fiduciary duties, the defendants clearly ratified the contract between Fumai and them since that time and thus lost the opportunity to avoid it. See § 380. Upon Allegheny’s introduction by Fumai as a potential buyer of ST and SM, the defendants met with Allegheny and eventually negotiated a sale and purchase between them. ST and SM received approximately \$11.5 million from the sale of part of the assets of ST and SM to Allegheny. Neither Allegheny nor the defendants have complained about the terms of that sale. Indeed, the defendants paid Fumai commissions from the sale on four occasions over the course of four years after the closing on the sale in the substantial sum of \$454,000. The defendants clearly demonstrated their affirmance of the contract by reaping the benefits of the contract and paying commissions to Fumai. Accordingly, I find that the defendants’ opportunity to exercise any power they had to avoid the contract was lost and the contract is valid and enforceable.

III. CONCLUSION

Because I find that the defendants' argument that the contract is void fails as a matter of law and that as a matter of law the defendants ratified the contract for commissions between Fumai and them, the defendants' affirmative defense or counterclaim regarding Fumai's alleged breaches of his fiduciary duties to Allegheny or the defendants as well fails as a matter of law and thus the evidence sought to be excluded is irrelevant and should indeed be excluded at trial. Thus, the defendants' motion for partial reconsideration was denied and Fumai's renewed motion in limine was granted in part in the Court's Order of January 9, 1998.³

LOWELL A. REED, JR., J.

³ For completeness, a copy of that Order is attached to this Memorandum as "Exhibit A."

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FRANK FUMAI,	:	CIVIL ACTION
	:	
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Plaintiff,	:	
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v.	:	
	:	
HARVEY LEVY, SUBURBAN	:	
THERAPY, INC., and	:	
SUBURBAN MEDICAL ASSOCIATES,	:	
	:	
Defendants.	:	NO. 95-1674

ORDER

AND NOW, this 9th day of January, 1998, upon consideration of the motion in limine of plaintiff Frank Fumai ("Fumai") (Document No.37) to preclude defendants Harvey Levy, Suburban Therapy, Inc. ("ST"), and Suburban Medical Associates ("SM") (collectively "the defendants") from arguing or introducing any evidence at trial that pertains or relates in any way to their claim or defense that Fumai breached a fiduciary duty owed to Allegheny United Hospitals ("Allegheny") in connection with the sale of SM and ST to Allegheny, and the motion of defendants for partial reconsideration of the Court's Order dated December 19, 1997 (Document No. 38), and for reasons which will be set out fully in the record by this Court, having summarized the reasoning of the Court as follows:

1. Under Pennsylvania law, assuming without deciding that Fumai owed fiduciary duties to Allegheny, based on his alleged employment by Allegheny, and to the defendants, based on the contract between the defendants and Fumai, and assuming without deciding that Fumai breached his fiduciary duties to Allegheny

EXHIBIT "A"

and the defendants by the actions he took or failed to take while purportedly acting in fulfillment of the contract between Fumai and the defendants, this Court concludes that Fumai's breaches of his fiduciary duties, if found, rendered the contract between Fumai and the defendant voidable, but the defendants' opportunity to avoid the contract was lost through their failure to disaffirm the contract in a timely manner and through their affirmative acts of (1) receiving the benefits of the sale and payment from Allegheny for the purchase of ST and SM and (2) making payments of commissions to Fumai claimed under the contract,

it is hereby ORDERED that Fumai's motion in limine is GRANTED IN PART and the defendants' motion for reconsideration is DENIED.

IT IS FURTHER ORDERED that because the unenforceability as against public policy defense is not available to defendants, the defendants are precluded from arguing or presenting evidence that pertains or relates to their asserted defenses that Fumai breached a fiduciary duty to Allegheny and to defendants, including argument or evidence regarding Fumai's employment relationship with Allegheny, whether and to what extent Fumai informed Allegheny of his agreement with the defendants to be paid a commission in connection with the purchase of SM and ST by Allegheny, the circumstances surrounding the Continental Medical Systems ("Continental") negotiations and Fumai's purported quashing of the incipient purchase of SM and ST by Continental.

IT IS FURTHER ORDERED that paragraph (2) of the Court's Order of December 19, 1997 (Document No. 34) remains in full force and effect.

/ss/ Lowell A. Reed, Jr.
LOWELL A. REED, JR., J.

EXHIBIT "A"